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## Bank of England turns hawkish, supporting sterling

**Global FX: Hawkish BoE supports sterling** – The Bank of England (BoE) left monetary policy unchanged as was widely expected. The MPC voted by a majority of 5-3 (3 in favour of a rate hike) to maintain the Bank Rate at 0.25% and kept QE unchanged. The statement mentioned that CPI inflation has risen above the 2% target because of the substantial decline in sterling last year. According to the BoE inflation could rise above 3% by autumn and is likely to remain above the target for an extended period. Meanwhile, pay growth has moderated further. The BoE said that it must balance any trade-off between the speed at which it intends to return inflation to target sustainably and the support that monetary policy provides to job growth and activity. We think that the BoE will keep monetary policy unchanged this year and the next because of the real income squeeze and the uncertainty related to Brexit. The immediate reaction after the decision and the release of the statement was sterling strength. This is because three members voted for a 25bp rate increase and because the statement mentioned “the continued growth of employment could suggest that spare capacity is being eroded, lessening the trade-off that the MPC is required to balance and, all else equal, reducing the MPC’s tolerance for above-target inflation”. We expect GBP to be relatively resilient versus US dollar and euro. Our year-end targets for GBP/USD and EUR/GBP are 1.30 and 0.88 respectively (Georgette Boele).

**Euro Politics: Can Macron change France and Europe?** - France will vote in the second round of the legislative elections this Sunday (18 June), with polls estimating that President Macron’s centrist political movement La République en Marche! (and its MoDem allies) will win a ‘crushing majority’, between 350 and 450 of the 577 seats available in the lower house. A considerable ‘presidential majority’ should give Macron the political means to carry through his ambitious economic reform package. Still, it must be emphasized that implementing reforms in France remains difficult, as they have been blocked by vested interests, street protests and strikes in the past. Indeed, the leader of the country’s largest trade union has already warned Macron not to rush through labour market reforms. Aside from much-needed economic reforms, Mr Macron plans to push for a EUR 50bn public investment drive during the five years of his term and a EUR 60bn cut in public spending. Besides his plans for the French economy, Mr Macron also has an ambitious agenda for further European integration and cooperation. However, we think the current plans do not go far enough to underpin the eurozone and differences of opinion between the core and periphery remain. For more on this please see: Eurozone Watch: Can Macron change France and Europe? (Aline Schuiling and Jean-Paul Honegger)

**US Macro: Consumers still cautious, but underlying fundamentals remain strong -**

Although incoming economic data have been weaker than expected, the June FOMC statement and economic projections released on Wednesday did not show much concern toward these developments. Looking in more detail at consumption, one of the major drivers of economic activity, the latest retail sales report released yesterday was a bit disappointing. Retail sales fell 0.3% mom in May, following an upwardly revised 0.4% in April. This upward revision partly offsets the decline in May. The retail sales control group, which is used to calculate GDP was unchanged in May, following a 0.6% increase in April. We expect consumption growth to increase in the coming quarters. Consumer surveys have edged down, but remain at high levels. Moreover, the labour market should continue to strengthen further. On top of this the savings rate remains elevated, leaving room for some extra spending. Other data released today, including industrial production showed some payback in May (0% mom) after reporting the strongest increase in almost seven years (1.1% mom). The Empire State Manufacturing survey for June shot up 21 points to 19.8, although this indicator can be quite volatile. Overall, we expect consumption to strengthen and factory output to firm in the second quarter. (Maritza Cabezas)

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